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IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. 684

JOSEPH F. HUGHES & COMPANY,
a co-partnership composed of
JOSEPH F. HUGHES and E. A. HUGHES,
Petitioners,

vs.

A. RAYMOND MACHEN,
Trustee in Bankruptcy of
CUMMINS CONSTRUCTION CORPORATION,
Bankrupt,
Respondent.

PETITIONERS' REPLY BRIEF

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PETITIONERS' REPLY BRIEF

I.

Petitioners' Statement of Facts Re-Examined

The respondent devoted a considerable portion of his brief to a denunciation of the Petitioners' statement of facts. And instances alleged misstatements therein.

Without fencing with our adversary the Petitioners reaffirm their statements of fact and without too extensive a reply respectfully offer the following observations.

Respondent (his brief at page 20) challenges the statement that the bankrupt concern had for months prior to its adjudication "ceased to function as an active and going

concern". But does the Trustee deny that for many months the concern had failed, in the ordinary course of business, to satisfy and discharge its creditors? Or does the Trustee deny that some four hundred thousand dollars, plus, of long overdue claims have been filed in this case? Does this known failure to discharge delinquent claims by this bankrupt, over a period of many months prior to its adjudication, constitute its functioning as a going concern? These are facts. The Trustee knows them to be facts. Why therefore should we have his cavil concerning such a statement?

Again, at page 22 of his brief, the Trustee, though careful not to deny that a large Government contract had been terminated,—indeed, the Trustee now supplies the date of termination,—protests that we somehow improperly stated "a large Government contract had been earlier terminated." This too was a fact. The Trustee and his counsel know it to be a fact, just as they know how much, or how little, was collected on the alleged claims of $400,000 to $500,000, asserted by the Bankrupt by reason of such termination by the Government (see page 4 of respondents brief).

The Courts long ago discarded the unwarranted attachment of inflated value by a bankrupt to a disputed claim in considering the insolvency of a company. Anyone at all can *assert* a claim; that does not impart value to it however.

See: Prudential Ins. Co. v. Nelson, (6th CCA), 96 F. (2) 487 at 490;
Grandison v. Bank, (2nd CCA), 231 F. 800 at 804-06.

Thus it was that the elimination of these repudiated claims against the Government—the officers are certainly to be charged with a knowledge of and familiarity with the affairs of their company—disclosed the clear bankruptcy

of the Company. Still the Trustee objects to the statement of the Petitioner that the company had ceased to function as a going concern and that the Government had earlier terminated a large contract. And yet both are correct statements of fact.

At page 23 of his brief the Respondent complains that in the course of argument by the Petitioner upon the proposition that the Guarantors, who were in active control of and operating the bankrupt firm, received a preferential benefit, it was said:

> "* * * though of course since they were in active control of the bankrupt and now admitted to have had prior knowledge of its insolvency (or better than reasonable cause to believe that the debtor was insolvent) these Guarantors may also be said to have induced or brought about a situation, by continuing to make deposits in the Banks holding the bankrupt's indebtedness * * *."

The Trustee's reply brief says that so much of this argument as infers that the Respondent made any such admission is incorrect. Reference to the opinion of the Circuit Court of Appeals (R. p. 127) is sharply illuminating; of course it must be remembered that this opinion was written after oral argument made in behalf of counsel for the respondent, during which the Court asked certain questions and received certain answers. The Court in its opinion, said:

> "The area of discussion will be much reduced if the position of the parties on certain questions, once at issue, but now in effect removed from the field of controversy, is first stated. * * * *Furthermore, it is not now disputed that on October 16th, 1944, when the banks took over the deposits, both they and the endorsers had reasonable ground to believe that the Construction Company was insolvent.*" (Italics supplied.)

Evidently not only counsel for the Petitioners, also present at the oral argument, but the Court itself, was made to realize that this fact was no longer in dispute.

In much the same vein we find Respondent (his brief, page 23) challenging the statement that the officers (Guarantors also) continued to make deposits in these banks in the weeks prior to October 16th, 1944, though they also maintained a third depositary, to which Bank the company was not indebted.

The Respondent, though hesitantly, suggests that it is inaccurate to make this statement, since an assistant treasurer physically made the deposits. The Respondent quickly recognizes however that "there can perhaps be no doubt that Mr. Hart would have obeyed instructions"; the Petitioner reiterates the proposition that the management and supervision of a close corporation of the character here involved, owned by the Guarantors as stockholders altogether, and alone directed by its officers is necessarily an intimate one, and the Officers and Directors cannot escape the responsibility that follows from their actual and constructive knowledge of the affairs and status of their company.

Still again the Respondent lectures that the Petitioner somehow is guilty of another misstatement by referring to the Guarantors as officers, directors and stockholders. The fact is that the Guarantors are either officers, directors or stockholders. At least three of the four are (would it be fair to say 'admitted' to be) officers and directors. And on page 3 of the Petitioners' brief in support of the Petition for a Writ, it was stated only that:

> "* * * Do not the Guarantors (officers, directors *or* stockholders of a family corporation) receive a voidable preference when, * * *". (Italics here supplied).

And again, for an illustration, the Respondent challenges the statement that the Petitioners are acting for creditors opposed to the alleged compromise. Instantly though the Respondent (at page 26 of his brief) recognizes that, if successful, the action taken by the Petitioners will benefit *all creditors*. Actually, as the Trustee knows, there is a pending suit, filed by the Petitioners, at their own cost, but for the benefit of *all creditors*, for recovery of the claimed preferential benefits received by the Guarantors. Counsel for the Petitioners, and the Respondent knows this to be a fact, has filed in the Court below powers of attorney from numerous creditors opposed to the alleged compromise; is there need to parade all of them before this Court as petitioners when one of their number will suffice.

And finally without further elaboration it appears that the Respondent (on page 27 of his brief) decrys the Petitioners statement that the Trustee is "a close personal friend and sometime business associate of the guarantors."

Nothing would be more simple to establish.

All of which the Trustee quite well knows.

The Respondent refers to a passage of the transcript in the record (R. pp. 107-108) and apparently accepts that as substantiation of the statement that the Trustee is "a close personal friend" of the guarantors. There is no need to belabor the conclusion; that is the testimony of one of the Guarantors, the President of the bankrupt; and certainly that is more than borne out by the mere circumstance of the Trustee's presence at the Banks on the occasion described. Mere creditors were not present!

But, asks the Respondent, is there any basis, in the record, for identifying the Trustee as a "sometime business associate" of the guarantors?

Does the Trustee deny the accuracy of the following statement, which appears in the Record. Can he dispute—as a matter of fact—what is mirrored here:

> "* * * and this case started from the very first meeting of creditors where we asked that the trustee who was appointed be disqualified *because of his friendship with the endorsers in this case who were in his employ,* and he had undertaken his (their) outstanding contract (R. p. 44). * * *" (Italics supplied).

As a matter of fact the Trustee cannot deny that he and the guarantors or some of them have been associated in business together!

Where is the warrant then for the disputatious tenor of the Respondent's brief?

II.

The Bank Cannot Retain The Assigned Funds

Elsewhere in his brief the Respondent (at pages 7 and 8) resurrects two rejected contentions. The first, that the language of the notes held by the Bank from the bankrupt could support that Bank's attempt to retain the proceeds which it received, within one month of adjudication, under the old unrevoked (but no longer effective) assignment which had been executed in 1942. The language of the notes (and they appear at Record pages 45-48)—without defining with any certainty the assets referred to—distinctly provides for application by the Bank toward the indebtedness at the *maturity* of the note of only "* * * moneys, stocks, bonds or other securities or property * * * on deposit with or held by, or in the possession of said bank, * * * or in transit to or from the bank by mail or carrier, * * *".

No part of the $45,103.73, one half of which the Bank attempted to apply on or about December 6th, 1944, was either on deposit with or in the possession of the Bank or in transit to it when any of the notes matured, and the last one of the three matured on October 25th, 1944.

Moreover *each of these three notes*, which the Trustee suggests may be employed as transferring to the Bank a still further right (beyond that of the old and no longer effective 1942 assignment itself) to obtain the $45,103.73 as collateral, *were executed within four months of the adjudication.*

These notes represented old obligations of the bankrupt only. They would in and of themselves be preferences if any such effect might be claimed by the Bank for them.

Moreover, any attempt by the provisions appearing in said notes to accomplish a further assignment of the Government proceeds was ineffectual (and unintended) since the Federal Statute permitting assignments of contract claims required the formal recording of all such assignments with the requisite Federal Agencies (which was not attempted in respect of these notes); and since each of the notes are dated within the four month period any attempt thereby to assign further security for the repayment of then outstanding loans would be condemned as a distinct and independent preference. Any such attempted assignment of the Government funds, since it *was not perfected by the required recording with the Federal Agencies its provisions* would be nugatory, if sought to be applied to the Government funds payable under the Cedar Point contract.

USCA, Title 41, Sec. 15 (1940);

See also:

RE; Seims Constr. Co. D.C., Md., 1941, 37 Fed. S. 855;
Authorities cited in the District Court opinion, R. p. 69;
Circuit Court opinion thereon, R. p. 127.

The second of the resurrected contentions (Respondent's brief at pages 7 and 8) now suggests that (1) although the express terms of the assignment in 1942 of such anticipated Government contract payments were limited so as to secure repayment only of loans made exclusively for the Cedar Point project, and (2) all such loans had been fully satisfied, — — the Bank is not prohibited "from retaining the assignment for another purpose."

As the clear facts in this case unqualifiedly disclose, to quote the language of the District Court opinion, it must be held:

> "From the facts existing at the time this fund was received by the bank, that the bank had no right to retain this money, except as in the nature of an agency or trust account for the bankrupt, seems beyond question. As explained previously herein, the contract with the Government had been terminated for the convenience of the latter in 1943, and all sums due the bank by the bankrupt and its co-contractor on account of the loan obtained from the bank for the purpose of completing the Government project, had been paid by September, 1944." (R. p. 67).

CONCLUSION

The Petitioners would have preferred to forego the presentation of this reply brief, but in view of the unfounded comment of the Respondent regarding the earlier statement of facts, it was considered desirable that this reply thereto be formally submitted.

And the Petitioners again respectfully submit that clearly analyzed the really pivotal matters of facts here involved are so free of dispute as to be virtually stipulated.

Without citing any authority whatsoever the Respondent, though offering no objection to the grant of the requested writ of certiorari on the question numbered "(2)", protests its grant as to the other important questions propounded. The Petitioners most earnestly and respectfully urge that the Court grant the writ upon all of these far-reaching questions, and not alone as to the one to which the Respondent offers no objection.

Respectfully submitted,

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April 22, 1948.